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BEFORE THE
# Federal Communications Commission
WASHINGTON, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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| In the Matter of | ) | |
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| Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996 | ) ) ) | CC Docket No. 96-128 |

**REPLY COMMENTS OF ARCH COMMUNICATIONS GROUP ON THE REMAND ISSUES**

Arch Communications Group, Inc.[1] submits this reply to the numerous comments filed in response to the *Public Notice* seeking comment on necessary modifications to the Commission's *Payphone Order* in light of the recent appellate court decision in *Illinois Public Telecommunications Ass'n.*[2] Arch addresses two issues in this reply: (1) the need for the Commission to reconsider its decision not to apply cost-causation principles to payphone cost recovery if it decides to retain a market pricing approach to payphone compensation; and (2) the argument of the payphone service provider ("PSP") industry that, in the name of "fair compensation," the Commission should permit them to charge a price 250% to 350% above their actual costs.

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1 Arch, a publicly traded company (Nasdaq: APGR), is the third largest provider of narrowband CMRS in the United States, providing wireless messaging services, primarily paging, to over three million customers in 41 states.

2 *See Public Notice,* "Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding," CC Docket No. 96-128, DA 97-1673 (Aug. 5, 1997). *See also Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 20545 (Sept. 20, 1996)("*Payphone Order*"), *on recon.*, 11 FCC Rcd 21233 (Nov. 8, 1996)("*Payphone Reconsideration Order*"), *vacated in part and remanded, Illinois Public Telecommunications Ass'n* v. *FCC*, 117 F.3d 555 (D.C. Cir., July 1, 1997)("*Remand Order*").

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## I. IF THE COMMISSION DECIDES TO RETAIN MARKET PRICING FOR PAYPHONE COMPENSATION, IT MUST RECONSIDER THE DECISION NOT TO APPLY SETTLED COST-CAUSER PRINCIPLES FOR COST RECOVERY

The Commission should reconsider during this remand proceeding its decision to adopt a "carrier pays" approach to payphone compensation. "Carrier pays" is inconsistent with the Commission's settled practice of recovering costs from the cost-causer. Equally important, it now appears that the factual predicate underlying a "carrier pays" system — each 800 customer will be able to avoid excessively priced payphones through blocking — will no longer occur in practice.

The Commission has "long held . . . that costs should be paid by the cost causer" and that its "goal [is] to impose costs upon the cost causer."[3]

> [W]e believe the public interest is best served, and a competitive marketplace is best encouraged, by policies that promote the recovery of costs from the cost causer.[4]

The cost-causer for purposes of payphone compensation is, as the Commission has acknowledged, the calling party — the person deciding to use the payphone.[5] As numerous comments point out, recovery of payphone costs from the calling party would allow market forces to control the prices PSPs charge for use of their payphones: if a PSP charges too much to use a payphone in originating an 800 call, for example, the calling party will either not make the

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3 *Expanded Interconnection Third Order,* 9 FCC Rcd 2718, 2728 ¶ 46 (1994), and *1985 Annual Access Tariff Filing,* 2 FCC Rcd 1416,1429 ¶ 33 (1987). *See also id.* at 1428 ¶ 118 ("[O]ur objective [is] to impose the cost burdens upon the cost-causer.").

4 *1985 Annual Access Tariff Filing,* 2 FCC Rcd 1416,1429 ¶ 34 (1987).

5 *Payphone Order* at ¶ 85.

call or make the call elsewhere.[6] This, in turn, should provide PSPs incentives to lower the prices they charge for use of their payphone.[7]

The Commission has decided, however, that PSPs should recoup their costs not from the cost-causer but from interexchange carriers. The problem with this "carrier pays" approach is that the cost-causer no longer influences the prices PSPs charge for use of their payphones. As the Personal Communications Industry Association ("PCIA") has explained:

> But if a caller incurs no charge to place a payphone call, the caller will not care if the call costs $0.10 or $10. Thus, a caller has no incentive to impose market discipline on PSPs by "price-shopping" for payphones. The "market," therefore, cannot set the price in the manner envisioned by the Commission.[8]

This market distortion is especially a problem for 800 service calls, where the call — and, under the Commission's current approach, the costs of using the payphone — are instead paid by the person being called.

The Commission acknowledged this problem with a "carrier pays" approach, but stated that it would be addressed by 800 carriers (either on their own behalf or on behalf of individual 800 customers) to block 800 calls from payphones charging excessive prices. The Commission confidently declared:

> The marketplace will ensure, over time, that PSPs are not over-compensated. Carriers have significant leverage within the marketplace to negotiate for lower per-call compensation amounts

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6 *See, e.g.,* AirTouch Paging at 2 ¶ 2; PageNet at 10-11.

7 However, experience in several western states where local coin rates are not regulated suggests that PSPs are unwilling to lower their local coin rates even when higher rates result in a significant loss of calling volumes. *See* Hausman Declaration at 13 ¶ 23, *appended to* RBOC/GTE/SNET Comments.

8 PCIA at 10.

> . . . and to block subscriber 800 calls from payphones when the associated compensation amounts are not agreeable to the carrier.[9]

The Commission further made clear that, for a "carrier pays" system to work successfully, each 800 service customer must have the flexibility to block calls from payphones charging excessive prices.[10]

This blocking alternative was also critical to the appellate court's decision to affirm the Commission's adoption of a "carrier pays" approach. Indeed, the court made clear that a "carrier pays" approach in a market-based compensation environment would be arbitrary and capricious *if* 800 service customers did *not* have the option to block calls originated from payphones:

> The Commission . . . concluded that the party incurring the cost could avoid it. . . . Thus, a "buyer" (the carrier *or* the 800 service subscriber) *will* have the option of rejecting a "seller's" (the PSP) excessively priced service. *Given this explanation,* the Commission's conclusion that a "carrier pays" compensation system will result in competitive market pricing of 800 service payphone per-call compensation charges was not arbitrary or capricious.[11]

In reaching this decision, the court relied upon the Commission's representation that 800 carriers "can and will develop blocking technology" so 800 service customers can block calls from excessively-priced payphones and, thus, avoid paying monopoly rents.[12]

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9 *Reconsideration Order* at ¶ 66.

10 *See Remand Order,* 117 F.3d at 566 ("Subscribers to an 800 service can utilize a carrier's call-blocking capability by negotiating with the carrier to block calls from payphones with excessive per-call compensation charge. *Order* ¶ 17.").

11 *Remand Order*, 117 F.3d at 566-67 (emphasis added).

12 *Id.* at 567.

Recent developments now confirm that the court's assumption — blocking "can and will" be available — is no longer founded in fact. As commenters point out, major 800 carriers — including AT&T — will not be deploying a blocking capability at all.[13] 800 service customers like paging carriers will not find relief even if smaller 800 carriers deploy a blocking capability. PSP providers and 800 carriers have now confirmed that, because of technical limitations, paging carriers and other 800 customers will *not* be given the option of blocking calls from certain payphones, but not others.[14]

The record now demonstrates conclusively that the factual predicate underlying the Commission's "carrier pays" decision, and the court's affirmation of that decision, is no longer valid. Consequently, if the Commission decides to retain a market-based approach to payphone compensation, it must either (1) order all 800 carriers to deploy blocking capability so *each* 800 customer has the option to block those 800 payphone calls it deems excessive, *or* (2) apply settled notions of cost-causation so payphone costs are instead paid by the cost-causer — the payphone user. Arch recommends that the Commission adopt the latter approach because it

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[13] *See, e.g.,* PCIA at 8 n.22 ("AT&T . . . has stated that it is not going to develop call blocking technology."). As commenters have explained and as the appellate court noted, IXCs "have no economic incentive to block calls" because they must spend money to lose revenue. *See Remand Order,* 117 F.3d at 564; PCIA at 8. The Commission never addressed this "IXC disincentive" problem in its *Payphone Orders.*

[14] *See* Whitepaper on the Provision of ANI Code Digits of the LEC ANI Coalition, CC Docket No. 96-128, at 7 (June 16, 1997)("[N]either LIDB/OLNS nor FLEX ANI will provide MCI with the information it needs to establish such a system" to block calls per the instruction of each 800 customer.); Cable & Wireless at 10-11 ("CWI's network can only accomplish blocking for EVERY call from a payphone. CWI cannot selectively block subscriber 800 calls, but continue to allow calls charged to calling or debit cards. CWI's network is capable of only a 'least common denominator' approach — blocking for one product or customer will necessitate blocking for every CWI product originating at the payphone.").

is less costly to implement and because, in the end, it is the only approach that will impose an effective check on the prices PSPs charge for 800 and other coinless calls.

## II. A COMPENSATION RATE THAT IS 250% TO 350% ABOVE COSTS IS GROSSLY EXCESSIVE AND CANNOT BE CONSIDERED "FAIR" COMPENSATION IN ANY CIRCUMSTANCE

Section 276 of the Communications Act specifies that PSPs are entitled to be "fairly compensated" for use of their payphone equipment.[15] As discussed below, PSPs argue that the Commission, in the name of "fair compensation," should give them the right to charge from between 250% to 350% above their actual costs. Clearly, in enacting Section 276, Congress did not envision that its "fair compensation" requirement would result in PSP compensation at such super-monopolist rents.

AT&T, which has extensive experience in operating payphones of all types, has documented in considerable detail that the cost of operating a coinless payphone approximates 11 cents per call.[16] This figure is confirmed by cost studies prepared by PSPs themselves. Earlier this year, NYNEX advised the Massachusetts Commission that its *total* cost of handling an end-to-end coin call was less than 17 cents.[17] As the appellate court noted, and as even the PSP industry acknowledged as recently as last year, there is "solid data" that the cost to process

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15 47 U.S.C. § 276(b)(1)(A).

16 AT&T at 8 and 10-11 and the appended Affidavit of David Robinson.

17 *See* Letter from Barbara Anne Sousa, NYNEX, to Mary L. Cottrell, Massachusetts Department of Public Utilities, D.P.U. 97-18, (March 31, 1997), *appended to* Sprint's Comments. Although NYNEX's study is not publicly available because it was filed under seal, importantly it "had every incentive to include every conceivable cost in its calculations in order to justify the proposed rate increase, including all costs . . . not incurred in originating the coinless calls at issue here." AT&T at 12-13.

a non-coin call is much lower than the cost of processing a coin call.[18] Record evidence demonstrates that the cost to process a coinless call is "about 45%" less than the cost of processing a coin call.[19] This would suggest that NYNEX's cost of handling 800 and other coinless calls approximates 9 cents.

Given this NYNEX cost data (ignored altogether by the PSP industry including NYNEX), it is not surprising that the PSP industry asks the Commission to instead "maintain its focus on market-based rates."[20] Although the appellate court ruled that the original "market rate" of 35 cents per call was excessively high,[21] and although the PSP industry once conceded that costs for coinless calls were less than coin calls,[22] the PSP industry now argues that the Commission should establish an *even higher* "market rate" (itself an oxymoron): with incumbent

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18 *Remand Order,* 117 F.3d at 564 *See also id.* at 563 ("Even the APCC, a trade group for independent PSPs, acknowledged that the costs of coin calls are higher than those of coinless calls.").

19 AT&T at 13-15.

20 APCC at 1. The PSP industry, while claiming on the one hand that their market is competitive, urges the Commission to adopt a Ramsey pricing approach to payphone compensation — although the Commission and leading economists have recognized that "Ramsey pricing principles were developed in the context of a regulated monopoly and not for markets subject to existing or potential competition." *LEC/CMRS Interconnection NPRM,* 11 FCC Rcd 5020, 5044 ¶ 51 (1996). *See also* Alfred E. Kahn & William B. Shew, *Current Issues in Telecommunications Regulation: Pricing,* 4 Yale J. on Reg. 191, 248 (1987)("The standard formula for Ramsey pricing assumes a monopoly supplier. The competition in telecommunications markets is likely to alter the prices that satisfy the Ramsey principle.").

21 The Competition Policy Institute cogently explains why 35 cents is *not* a market-based rate for payphone charges and rather constitutes "the *monopoly* price for local coin calls." Institute at 3 (emphasis in original).

22 *See* note 18 *supra; see also* RCN Telecom at 3.

LEC PSPs urging the establishment of a "market rate" of at least 42 cents,[23] and independent PSPs contending that a "market rate" as high as 45 cents would be permissible.[24] Given the evidence that a PSP's actual cost of processing a coinless call is *at most* 11 cents (and more likely less[25]), the PSP industry wants the Commission to sanction prices 250% to 350% above their costs. Under no circumstance can it be said that prices this high constitute "fair compensation" within the meaning of Section 276 of the Communications Act — or in the PSP's industry's words, fall within a "zone of reasonableness."[26]

The PSP industry argues that there is "no need for the FCC to conduct a painstaking costs analysis."[27] Arch agrees. Section 276 specifies only that payphone compensation shall be "fair," not exact. AT&T has adequately documented the costs of handling

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23 RBOC/GTE/SNET Payphone Coalition at 30-31.

24 APCC at 10.

25 *See* Sprint at 11 ("bellweather per-call rate" appears to be 5.7 cents); MCI at 3 (Hatfield study demonstrates per-call costs of a coinless call of 8.3 cents).

26 APCC at 5.

27 APCC at 5. Completely without any factual support is the incumbent LEC representation, repeated numerous times, that "[e]ven at a per-call compensation rate of $.35, twenty percent of all payphones are at risk of removal, and each penny reduction below $.35 will cause the removal of thousands more." RBOC/GTE/SNET Coalition at 24. At the outset, the Housman Affidavit does *not*, as these LECs assert, support this factual assertion; the assertion is contained only in a brief, conclusory footnote in the Anderson Report (at 13 n.13). More fundamentally, this assertion is contradicted by the PSP's industry's own statements. *See* Sprint at 4-5. Finally, even if there were some truth to this undocumented assertion, money-losing payphones could be considered for treatment as "public interest telephones." *See* 47 U.S.C. § 276(b)(E)(2).

coinless calls from payphones, and Arch therefore recommends that the Commission establish a default rate for no more than 11 cents for each completed coinless call.[28]

The disparity between PSP's actual costs and the purported market rate does confirm a material fact noted by most commenters: "[t]he payphone industry in 1997 is far from competitive."[29] If the payphone industry were competitive, one would expect to see prices based on marginal costs.[30] Instead, we have the industry arguing that the government should establish a "market price" 250% to 350% above their costs. As a member of a fiercely competitive paging industry, Arch can state with confidence that participants in competitive industries do not — and, indeed, *cannot* — establish prices two or three times above their costs.

Whatever approach the Commission may ultimately adopt, it should not — and cannot — authorize anyone, including PSPs, to charge a rate 250% to 350% above their costs.

## III. CONCLUSION

The Commission needs to make a choice. If it wants to rely on market forces, it must allow market forces to operate fully and freely — that is, it must adopt a "calling party pays" system so the cost-causer can impact the prices each PSP charges (by refusing to pay excessive payphone charges). If, however, the Commission wants to retain the "carrier pays"

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28 The Commission could give each PSP the flexibility to seek a higher rate if it can establish that its forward-looking economic costs exceed 11 cents. However, Arch believes that this approach is unnecessary because the statute states only that compensation should be "fair," and inefficient operators in a competitive market should not be rewarded for their inefficiency.

29 Competition Policy Institute at 3.

30 *See id.* at 7 ("It is an axiom of economics that a competitive market will produce prices that are based on marginal *costs*. A competitive market will not countenance a producer that persistently charges more than the cost of producing a product.")(emphasis in original).

system, given all the problems with blocking, it must take steps to ensure that PSPs receive fair compensation, but not excessive compensation. Under no circumstances should PSPs be permitted to gouge consumers by charging prices 250% to 350% above their costs.

Respectfully submitted,

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September 9, 1997

## CERTIFICATE OF SERVICE

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